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**DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT**  
**Randall A. Deems, Acting Director**

**Marc Wilson, Deputy Director**  
**Ed Nielsen, Chief Auditor**  
**Special Projects and Accountability Division**

**Fresno County Enterprise Zone Audit Report**

**June 26, 2013**

# Fresno County Enterprise Zone Audit Report

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### Auditor:

*Kelly Moeckly, Auditor-in-Charge*

*Edward Nielsen, Chief Auditor*

### Distribution

*Randall Deems, Acting Director*

*Marc Wilson, Deputy Director, Special Projects and Accountability Division*

*Edward Nielsen, Chief Auditor*

*Victor Bribiesca, Fresno County Lead Enterprise Zone Manager*

*John Nunn, Program Manager, HCD EZ Program*

## ENTERPRISE ZONE OVERVIEW

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The State Enterprise Zone (EZ) Program represents California's primary economic development program. Eligibility for EZ designation is limited to jurisdictions that can demonstrate needs related to economic conditions, such as high poverty or unemployment rates. The original hypothesis behind the EZ Program is that by targeting significant economic incentives to disadvantaged communities, these communities will be more effective in competing for new businesses and retaining existing businesses. The anticipated results are increased tax revenues, less reliance on social services, and lower public safety costs. Residents and businesses directly benefit from these more sustainable economic conditions through improved neighborhoods, business expansion, and job creation.

The State Department of Housing and Community Development (HCD) is responsible for the EZ designation process and program oversight. The EZ program, after designation, is a 15-year partnership between local governments, government agencies, non-governmental agencies and private businesses to generate new private-sector investment and growth. To assist in this partnership, the State establishes a geographical area in which businesses may be eligible for exclusive State incentives and programs, which include the following:

- tax credits for sales and use taxes paid on qualified machinery;
- tax credits for hiring qualified employees;
- a 15-year net operating loss carry-forward;
- accelerated expense deductions; and
- priority for various state programs, such as State contracts.

In addition, California Revenue and Taxation Code Section 17053.74 governs the tax credit for a taxpayer who employs a qualified employee in an EZ. The tax credit is applied as follows:

- 50 percent of qualified wages in the first year of employment.
- 40 percent of qualified wages in the second year of employment.
- 30 percent of qualified wages in the third year of employment.
- 20 percent of qualified wages in the fourth year of employment.
- 10 percent of qualified wages in the fifth year of employment.
- Cap on EZ employment tax credit of \$37,440.

By statute, all EZs are required to report on their activities relative to their goals, objectives, and commitments as stated in the application for designation and HCD's Memorandum of Understanding (MOU) with the EZ. HCD has the authority to audit, at least once every five years, any designated EZ during the duration of the designation. In addition, HCD shall, for each audit, determine a result of superior, pass, or fail, per California Government Code Section 7076.1.

# Fresno County Enterprise Zone Audit

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## Introduction

The Fresno County EZ is one of 40 EZs in California providing tax incentives to qualified businesses. The EZ was designated June 27, 2007 through June 26, 2021.

## Unique Characteristics of the Fresno County Enterprise Zone

1. The Fresno County Enterprise Zone is comprised of the following fourteen cities:

City of Clovis	City of Coalinga
City of Firebaugh	City of Fowler
City of Huron	City of Kerman
City of Kingsburg	City of Mendota
City of Orange Cove	City of Parlier
City of Reedley	City of Sanger
City of San Joaquin	City of Selma

2. The Economic Development Corporation of Fresno serving Fresno County (EDC) acts as the Lead EZ Manager in charge of coordination of all programs and activities.
3. Each participating city has a designated EZ manager who works with the Lead EZ manager on EZ activities.
4. Some cities have their own economic development and marketing programs.
5. Processed over 5,000 voucher certificates from January through December 2012.
6. The EZ charges \$75 per application. Of this fee, \$15 is sent to HCD and \$60 is retained by Fresno EZ.
7. Fresno County EZ uses a web-based application to accept and process EZ voucher applications.
8. EZ vouchering agents, that process voucher applications, are not full-time EZ employees and are not under the supervisory authority of the Fresno EZ manager.

## Audit Objectives

The HCD auditors evaluated Fresno's EZ performance toward meeting the goals, objectives, and commitments, as stated in their EZ application, MOU and MOU Supplemental with HCD. At the conclusion of the audit process, a performance score was determined, based on Fresno's documentation supporting its achievement of goals and objectives related to EZ administration, marketing, budgeting, vouchering, and other relevant activities [CGC Section 7076.1(b)]:

- Determine whether the EZ Program is effective in the delivery of program goals, objectives, and commitments.
- Determine whether the EZ submits reports timely and is sufficiently managing compliance responsibilities.
- Assess compliance with EZ Act, California Code of Regulations, and HCD authorized procedures.
- Determine a performance score of superior, pass, or fail based on an evaluation of the program activities, responsibilities, and other factors contributing to the Fresno EZ program performance.

## **Fresno County Enterprise Zone Audit (continued)**

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### **Audit Authority and Guidance**

- Government Code Section 7070
- California Code of Regulations, Title 25, Division 1, Chapter 7, Subchapter 21, Articles 1-14
- California RTC Section 17053.74
- HCD Management Memos
- HCD Application for Designation Guidebook, HCD EZ Monitoring Guidebook
- Fresno EZ Application for Designation; EZ policies and procedures
- Internal control best practices

### **EZ Audit Scope**

- Fresno EZ application and MOU
- Fresno EZ performance reports
- Fresno EZ Biennial report
- Voucher process and periodic monthly reports
- Activities and documentation available for the audit period

### **Audit Methodology**

- Review Cal. Government Code Section 7070-7089 and 7097-7099, California Code of Regulations, and HCD guidance on reporting requirements
- Review Fresno EZ application and MOU
- Review Fresno EZ self-evaluation report; Biennial report; monthly reports to HCD
- Review program policies and procedures; and EZ website
- Interview Fresno EZ manager and staff

### **Audit Sampling Methodology**

1. **Voucher Program** – To select the sample for testing, specific parameters were defined for voucher applications that were approved or denied during the period, January to December 2012.
  - HCD auditors identified 70 voucher applications for all qualifying categories (A-K) for testing. The 70 applications selected were tested to determine if voucher application approvals met regulatory requirements.
  - Sampling method:
    - For each category with less than five total applications received, all were tested.
    - Categories with 5 through 99 applications, 5 applications were tested.
    - Categories with 100 through 299 applications, 10 applications were tested.
    - A minimum of 70 applications are tested, per EZ.
  - Voucher number sequence was verified to determine if voucher numbers were appropriately issued.

## Fresno County Enterprise Zone Audit *(continued)*

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2. **Monthly Reporting** – comparison of January through December 2012 monthly reports and voucher activity log:
  - January to December 2012 monthly reports were compared to the voucher activity log to determine any reporting discrepancies.
  - HCD auditors verified Fresno EZ monthly report dates and compared that information to the date that HCD's EZ Program received the reports to determine report timeliness.
  - HCD auditors verified the accuracy of the information provided on the Fresno EZ monthly reports.
  - Reconcile remittance amounts and the count for voucher applications.
  - Identify if applications were from an active or expired EZ.
3. **EZ Application, MOU, and Self-evaluation** - support documentation was compared to goals, objectives, and commitments to determine the level of achievement.

## Fresno Enterprise Zone's Performance Score and Adequacy of Controls

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### ***Performance Score: Fail***

Fresno's EZ audit failure was based on an overall lack of achievement and documentation for budget commitments, voucher administration and timeliness of regulatory required reports.

**Note:** The audit score achieved by a G-TEDA (EZ) is governed by CCR Section 7076.1, with the G-TEDA being able to achieve a score of: Superior (100 percent), Pass (99 to 75 percent) or Fail (< 75 percent). A G-TEDA audit score of less than 75 percent (below 75 percent in meeting goals, objectives, and commitment) will require a formal agreement between HCD and the G-TEDA. The agreement will be for a maximum of 180 days, by the end of which all audit findings must be remediated.

### **Adequacy of Controls**

The Fresno EZ audit documented areas of weak internal controls that led to the audit findings. This was evidenced by noncompliance with regulations, the EZ application, the EZ MOU and HCD policies and procedures.

Auditors noted noncompliance with the following:

- Non-compliant voucher administration process
- The funding committed to the Fresno EZ Program is not being provided and/or documented per regulatory requirements.
- Monthly reports and fee remittance were not being submitted to HCD according to regulatory requirements.
- Self-evaluation process documentation does not meet contractual obligations.
- Self-evaluations are not being performed to measure progress made in meeting all goals, objectives and commitments that were established with the granting of EZ designation.

The Fresno EZ audit performance score was determined based on documentation available (at time of audit) about its achievement of goals and objectives related to EZ administration, marketing, budgeting, vouchering, accomplishments, responsibilities, and regulatory related activities.

## Fresno County Enterprise Zone Audit Finding Log

Fresno's EZ log of audit findings includes the compliance or control issue, how the issue was noted and the criteria/risk that should be complied with or managed. Since Fresno EZ received a G-TEDA audit score of "Fail", no recommendations are suggested for the remediation of audit findings. Instead, a formal written agreement, to address all EZ audit findings, will need to be executed between HCD's EZ Program and Fresno County EZ.

	Finding/Criteria/Recommendation	Action Plan	Action Owner	Estimated Completion Date
1	<p><b><u>Voucher Program Administration</u></b> The administration of the vouchering process is done by a Fresno County EDC.</p> <p><u>Findings</u> The analysis of the voucher process and test samples of the voucher applications supported the following:</p> <ul style="list-style-type: none"> <li>• Voucher application documentation did not meet accuracy and/or timeliness criteria.</li> <li>• Monthly G-TEDA reports submitted late.</li> <li>• Voucher certificates issued when not in compliance with regulatory requirements. This audit finding's error rate (3%), if extrapolated to the annual voucher population processed by Fresno (about 5,000), would indicate approximately 150 non-compliant vouchers being issued annually resulting in a significant loss of State revenue.</li> </ul> <p><u>Criteria</u> CCR Title 25 Section 8463 Administration of a Vouchering Program, Section 8466, HCD Management Memo 8-01, 11-01.</p>	<p><b>Management's Action Plan:</b></p> <p>Fresno County EZ must enter into an agreement, per regulatory requirements, with HCD's EZ Program that will address all audit findings contained within the "Fresno County Enterprise Zone Audit Report".</p>	<i>Fresno County EZ</i>	<i>Governed by statute</i>



	Finding/Criteria/Recommendation	Action Plan	Action Owner	Estimated Completion Date
2	<p><b><u>Business Administration</u></b> The EDC has been the administration of the EZ since June 2011.</p> <p><u>Finding</u> Not conducting self-evaluations to determine the progress made towards meeting goals, objectives, and commitments. Per MOU Supplement on a continuously, monthly and/or annual basis.</p> <p><u>Criteria</u> Title 25 CCR Section 8462 Designation of Zone Manager and Staffing; Application/MOU between HCD EZ Program and Arvin EZ.</p>	<p><b>Management's Action Plan:</b></p> <p>Fresno County EZ must enter into an agreement, per regulatory requirements, with HCD's EZ Program that will address all audit findings contained within the "Fresno County Enterprise Zone Audit Report".</p>	Fresno County EZ	Governed by statute
3	<p><b><u>Budget</u></b> The funding committed to the Fresno EZ Program is not being provided and/or documented per regulatory requirements.</p> <p><u>Finding</u> Not tracking in-kind commitments by EZ participating jurisdictions and FCEZ partners to the EZ.</p> <p><u>Criteria</u> Title 25 CCR Section 8462 Designation of Zone and Manager and Staffing; MOU and MOU Supplemental.</p>	<p><b>Management's Action Plan:</b></p> <p>Fresno County EZ must enter into an agreement, per regulatory requirements, with HCD's EZ Program that will address all audit findings contained within the "Fresno County Enterprise Zone Audit Report".</p>	Fresno County EZ	Governed by statute
4	<p><b><u>Vouchering Fees</u></b> EZ receives the voucher application fee though EZ Web portal at <a href="http://www.fresnocountyez.com">www.fresnocountyez.com</a>. FCWIB (Investment Board) issues a fee check made payable to HCD EZ Program.</p> <p><u>Finding</u></p> <ul style="list-style-type: none"> <li>Application fees are not submitted to HCD by the 25th of the month, following receipt.</li> </ul> <p><u>Criteria</u> Title 25 CCR Section 8433 Procedure for Remittance of Department Fees (a); EZ MOU.</p>	<p><b>Management's Action Plan:</b></p> <p>Fresno County EZ must enter into an agreement, per regulatory requirements, with HCD's EZ Program that will address all audit findings contained within the "Fresno County Enterprise Zone Audit Report".</p>	Fresno County EZ	Governed by statute

